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C O N F I D E N T I A L SECTION 01 OF 02 VIENNA 001939

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TAGS: ENRG EPET PGOV EUN AU
SUBJECT: GOVERNMENTS COMMIT TO NABUCCO PIPELINE -- INDUSTRY
FACTORING IN IRAN

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Classified By: Economic-Political Counselor Gregory E. Phillips for
reasons 1.5 (b) and (d).

Summary

¶1. (C) At a June 26 conference, senior government officials from Austria, Hungary, Romania, Bulgaria, and Turkey, as well as EU Energy Commissioner Andris Piebalgs, signed a joint declaration to initiate the Nabucco pipeline project. Construction of the Euro 4.6 billion ($5.8 billion) pipeline should begin in 2008, with operation scheduled for 2011 or ¶2012. Initial capacity should be 8-13 billion cubic meters (bcms), rising to 25.5-31 bcms by 2020. The Nabucco consortium, consisting of Austria's OMV, Hungary's MOL, Romania's Transgaz, Bulgaria's Bulgargaz, and Turkey's BOTAS, is seeking 1-2 additional strategic partners in an effort to attract robust international financing. The project must still obtain several exemptions from the European Commission, but OMV, the lead Austrian company, is confident it will obtain Brussels' consent. According to OMV, the bulk of the initial capacity will come from Azeri or Iranian fields. Egypt, Syria, and Iraq are other probable suppliers, and Kazakhstan and Turkmenistan might enter the mix at some point. OMV told us that Russia could also participate in Nabucco, perhaps through Blue Stream, but OMV was adamant that Russia would not obtain any controlling function in the project. End Summary.

Diversifying Europe's Gas Supplies

¶2. (U) During a June 26 conference in Vienna, senior government officials from Austria, Hungary, Romania, Bulgaria, and Turkey, as well as EU Energy Commissioner Andris Piebalgs, signed a joint declaration to "successfully complete" the Nabucco gas pipeline project. CEOs from the five companies participating in the Nabucco consortium also attended the conference, as did representatives from the European Investment Bank, International Energy Agency, and the Stability Pact for Southeastern Europe. Austrian Economics and Energy Minister Martin Bartenstein characterized Nabucco as "Europe's most important energy project," one which will diversify Europe's gas suppliers and transport routes. According to Bartenstein, the January cut-off of Russian gas was a "wake-up call for the EU." However, Bartenstein stressed that the project does not aim to exclude Russian gas from Europe, adding that relations with Russia and Gazprom are excellent. Bartenstein underscored that Gazprom's plans for a Southeastern European Gas Pipeline would not affect the project, as Nabucco will cover only one-tenth of Europe's medium-term demand. In 15-20 years, Europe will need an additional 250 bcms, with total import demand increasing to 300 bcms. Nabucco's maximum capacity will be only 31 bcms.

¶3. (U) Construction of the 3,300 kilometers long pipeline should start in 2007 or 2008. The estimated cost is Euro 4.6 billion ($5.8 billion). Potential suppliers include Azerbaijan, Iran, Iraq, Egypt, and Russia. Initial capacity in 2011 should be 8-13 billion cubic meters (bcms), increasing to 25.5-31 bcms by 2020. Approximately half of the gas will reach West European markets via Austria's Baumgarten gas hub, with the transit countries off-loading the remaining half. The Nabucco project consortium has formed a joint subsidiary, the Nabucco Gas Pipeline International GmbH. Austria's OMV, Hungary's MOL, Romania's Transgaz, Bulgargaz, and Turkey's BOTAS each hold a 20% share in the subsidiary.

Nabucco Seeks EC Exemptions, Strategic Investor
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¶4. (SBU) During a June 28 meeting with EconUnit Chief, Otto Musilek, Director of OMV Gas, said the conference had been a success. In Musilek's opinion, without the Russian cut-off in January, such a conference would never have taken place. Musilek said that the biggest concern entering the conference had been Turkey's tepid support for the project. Turkey, according to Musilek, wants cheap gas from Iran as part of the Nabucco deal. Musilek added that the Turkish Government and BOTAS appear to be much more receptive to Nabucco following the conference. Musilek noted that OMV officials had detected a new level of enthusiasm at follow-up working level meetings with BOTAS on June 27.

¶5. (C) Musilek emphasized that Nabucco still needs exemptions from the European Commission to ensure the

project's viability. The consortium is seeking an exemption from Article 22 of the Internal Gas Market Directive 2003/55/EC, which establishes "regulated third party access" to transmission and distribution networks. The Nabucco investors want to reserve a certain capacity for themselves to ensure sufficient capacity. Secondly, the consortium wants a 20-year holiday from a regulated transmission fee. Musilek maintained that potential Nabucco shareholders will expect a minimum rate of return of 13%, far above the anticipated regulated return of 6.5%. There have apparently been six applications for exemption under Article 22 and the EC or national regulators have approved all of them. According to Musilek, Piebalgs told him privately that the EC would approve these exemptions, as long as the consortium followed the EC's procedures.

¶6. (C) The consortium will finance one-third of the project, and look to the financial markets for the remaining two-thirds. Musilek admitted that the consortium needs to bring in 1-2 additional strategic investors, with a higher credit rating, to attract robust financing. He said that OMV is conducting confidential talks with four possible investors -- EoN Ruhrgas, RWE, Gaz de France, and Total. Musilek noted that the great majority of the Nabucco gas would transit to France or Germany, with some to the Czech Republic, so OMV would welcome participation by a German or French gas company.

Nabucco Timeline -- Operational by 2011 or 2012
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¶7. (SBU) In 2007, in addition to finding a new strategic investor, Musilek said the consortium hopes to secure transport and supply contracts, negotiate right-of-way agreements in transit countries, and begin social and environmental impact assessments. Construction should start in 2008, with the pipeline operational in 2011 or 2012. Musilek emphasized OMV did not want any slippage past 2012, because many of the participating countries have contracts with Gazprom that expire in 2011-2012. At that time, Nabucco

must be a viable alternative or supplement to Gazprom for these countries. Musilek maintained that none of the participating countries were willing or able to move away completely from Russian gas supplies.

Azeri, Iranian Supplies Vital for Nabucco

¶8. (SBU) Musilek conceded that Nabucco needs the overwhelming bulk of the initial 8 bcms in capacity to come from Azerbaijan and/or Iran. Musilek acknowledged that commercial negotiations with Iran are consistently difficult and that the political situation in Iran is not promising. Musilek pointed to Syria, Egypt, and Iraq as possible suppliers to Nabucco. On Egypt, he opined that transport of Egyptian gas to OMV's planned new LNG terminal in Croatia was a better option than routing the gas through Nabucco. Kazakhstan and Turkmenistan offer potential in the future, but Musilek noted that lack of a trans-Caspian pipeline would exclude their participation at the moment. Nevertheless, Musilek added that OMV, through its 2004 takeover of Romania's Petrom, had acquired concessions to Kazakh gas deposits.

Russia and Nabucco

¶9. (C) Russia, according to Musilek, has become very adept at being "an irritant everywhere" in the energy sector. For instance, Musilek said OMV had information that Gazprom was recently attempting to entice MOL to develop an alternative route through Hungary. Russia is also advocating for Nabucco to circumvent Romania and transit through Serbia instead. Musilek said Nabucco would most likely develop a spur into Serbia, but it would not exclude Romania from the project. Blue Stream, which is only operating at 30%, could also feed into Nabucco. From the Russian perspective, this would give Moscow more flexibility by diversifying transport routes. Musilek said that OMV is not opposed to Russian gas flowing through the Nabucco pipeline. However, he adamantly stressed that, while Russian gas might be a part of the Nabucco project, it would not be a controlling part.
Kilner